INTRODUCTORY SECTION

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November 26, 2002

To the Citizens, Governor, and Legislators of the State of Colorado

It is our privilege to present the Comprehensive Annual Financial Report (CAFR) on the operations of the State of Colorado for the fiscal year ended June 30, 2002. This report is prepared by the Office of the State Controller and is submitted as required by Colorado Revised Statutes 24-30-204. The State Controller is responsible for managing the finances and financial affairs of the state and is committed to sound financial management and governmental accountability.

We believe the financial statements are fairly presented in all material aspects. They are presented in a manner designed to set forth the financial position, results of operations, and changes in net assets or fund balances of the major funds and nonmajor funds in the aggregate. All required disclosures have been included to assist the members of the General Assembly, the financial community, and the public in understanding the state's financial affairs.

The financial statements contained in the CAFR are prepared in conformity with generally accepted accounting principles applicable to government as prescribed by the Governmental Accounting Standards Board (GASB), and are audited by the State Auditor of Colorado. Those principles mandated significant changes to the content and format of the statements for Fiscal Year 2001-02 including a section titled Management's Discussion and Analysis (MDA), which contains much of the information previously presented in this transmittal letter. In addition to the basic financial statements, the CAFR includes: combining financial statements that present information by fund category; certain narrative information that describes the individual fund categories; supporting schedules; and statistical tables that present financial, economic, and demographic data about the state.

The funds and entities included in the CAFR are those for which the state is financially accountable based on criteria for defining the financial reporting entity as prescribed by GASB. The primary government is the legal entity that comprises the major and nonmajor funds of the state, its departments, agencies, and state funded institutions of higher education. It also includes certain university foundations that have been included with the institution that is financially accountable for the foundation.

The state's elected officials are financially accountable for legally separate entities that qualify as component units. Financial results of the state's component units are discretely presented in the financial statements. The following entities qualify as component units of the state.

Denver Metropolitan Major League Baseball Stadium District
University of Colorado Hospital Authority
Colorado Water Resources and Power Development Authority
CoverColorado (formerly known as Colorado Uninsurable Health Insurance Plan)

Additional information about these component units and other related entities is presented in Note 2 of the financial statements (See page 64). Audited financial reports are available from each of these entities.

PROFILE OF THE STATE OF COLORADO

Colorado became the thirty-eighth state of the United States of America when it was admitted to the union in 1876. Its borders encompass 104,247 square miles of the high plains and the Rocky Mountains with elevations ranging from 3,350 to 14,431 feet above sea level. The state's major economic sectors include agriculture, manufacturing, technology, tourism, energy production, and mining. Considerable economic activity is generated in support of these sectors by government, wholesale and retail trade, transportation, communications, public utilities, finance, insurance, real estate, and other services. Given the state's semi-arid climate, water resource development, allocation, and conservation are ongoing issues for state management.

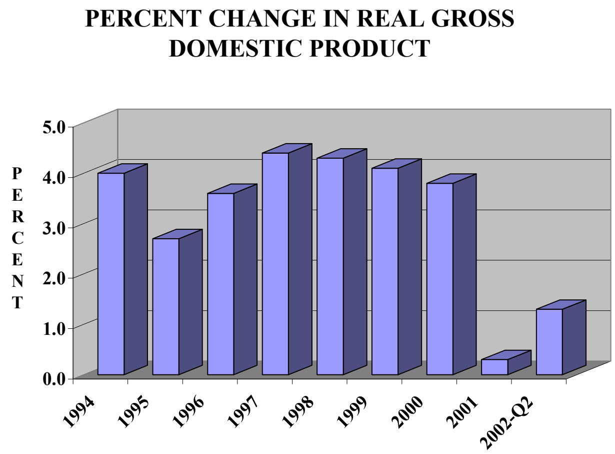
The state maintains a separation of powers utilizing three branches of government – executive, legislative, and judicial. The executive branch comprises four major elected officials – Governor, State Treasurer, Attorney General, and Secretary of State. Most departments of the state report directly to the Governor; however, the Departments of Treasury, Law, and State report to their respective elected officials, and the Department of Education reports to the elected State Board of Education. The elected officials serve four-year terms with the number of terms limited in duration.

The Legislature is bicameral and comprises thirty-five senators and sixty-five representatives who are also term limited. It is a citizen legislature whose general session lasts 120 days beginning in January of each year. Special sessions may be called by the Governor at his discretion and are limited to the topics identified by the Governor. The Legislature's otherwise plenary power is checked by the requirement for the Governor's signature of its legislation and by specific limitations placed in the State Constitution by voters. The most significant of these limitations is the restriction related to issuing debt, raising taxes, and changing existing spending limits. From a fiscal perspective, the Joint Budget Committee of the Legislature, because of its preparation of the annual budget and supplemental appropriations bills, holds the most important power vested in the Legislature. The Committee is bipartisan with members drawn from each of the houses of the Legislature. The Governor's Office of State Planning and Budgeting develops an executive branch budget proposal, but there is no requirement for the Joint Budget Committee to adopt that proposal.

The Judicial Branch is responsible for resolving disputes within the state, including those between the executive and legislative branches of government, and for supervising offenders on probation. The branch includes the Supreme Court, Court of Appeals, and district and county courts, served by 256 justices and judges in 22 judicial districts across the state (excluding 17 Denver county court judges). Municipal courts are not part of the state system. There are also seven water courts, one in each of the major river basins. The Judicial Branch budget is appropriated by the Legislature, and it is funded primarily from general-purpose revenues of the General Fund.

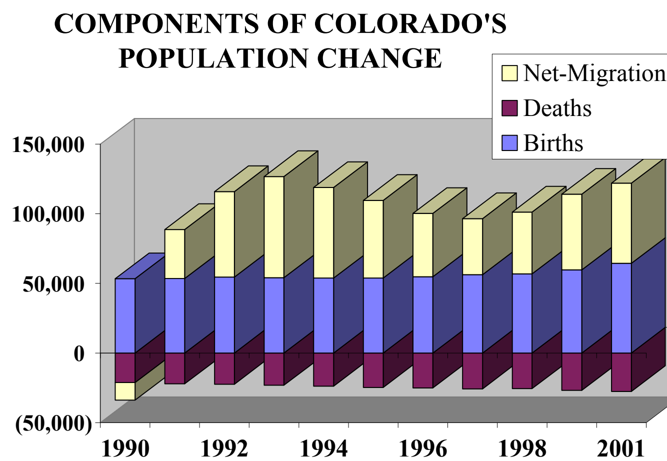
ECONOMIC CONDITION AND OUTLOOK

Fiscal Year 2001-02 opened with a $61.6 million reduction in anticipated General Fund revenues setting a pattern of declining revenue expectations that continued throughout the year. By the end of the fiscal year, the General Fund revenue estimates had been reduced by $1.02 billion. The state's revenues were significantly impacted by national events.



The tragic and brutal attack on the World Trade Center on September 11, 2001, caused immeasurable physical and mental suffering for the nation and Colorado. The attack also worsened the nation's and Colorado's economic problems. During the fiscal year, national unemployment grew from 4.6 percent to 5.9 percent, while Colorado's unemployment grew from 3.4 percent to 5.0 percent (after hitting a peak of 5.7 percent in February 2002). Growth in real gross domestic product was anemic at the national level dropping to .3 percent growth for 2001. After a promising first quarter in 2002 (5 percent growth rate), annual GDP growth dropped to 1.3 percent in the second quarter of 2002. The decline in GDP growth was led by a reduction in gross private domestic investment of 10.7 percent. With the general constriction of the state economy, inflation was not a significant factor during Fiscal Year 2001-02. The Governor's Office of State Planning and Budgeting identified travel, tourism, technology, and telecommunications as the Colorado sectors hardest hit by the economic slowdown, but cited manufacturing and energy production as strong areas of the state economy.

In Fiscal Year 2001-02, in spite of the downturn in Colorado's economic fortunes, net in-migration reached its highest level since 1994. The information in the adjacent chart is based on Census Bureau estimates. Data for the year 2000 is not included in the chart because a large adjustment was made to total state population for that year, and matching estimates for deaths and births are not available for that year.



The Governor's Office of State Planning and Budgeting (OSPB) anticipates that the Colorado economy will remain on a slow growth path in 2002 and then will begin to strengthen in 2003. In predicting slow near-term growth, OSPB cites causes including the slow national economic recovery, the depth of the advanced technology recession, and the continuing impact of September 11 on travel and tourism. Following is the OSPB forecast for Colorado's major economic variables at June 20, 2002:

- Employment will decline .6 percent in 2002, resume modest growth of 2.3 percent in 2003, and accelerate to 2.9 percent by 2004.
- Unemployment will average 5.2 percent in 2002, 4.8 percent in 2003, and decline to 3.8 percent by 2006.
- Wages, salary, and total personal income growth will continue to be slow through 2002 then will increase through 2004.
- In-migration is expected to slow to 1.7 percent through 2006 after reaching 2.2 percent in 2001.
- The Denver-Boulder-Greeley inflation rate is forecasted to be 3.0 percent in 2002 and then average 3.7 percent annually by 2006.

MAJOR GOVERNMENT INITIATIVES

During Fiscal Year 2001-02, the establishment of new programs was limited because of the significant shortfall in anticipated revenues. As a result much of the fiscal legislation that was passed was in reaction to existing financial problems rather than establishing new programs. Nonetheless, the following significant changes will affect the state's future fiscal operations.

House Bill 02-1310 and Senate Bill 02-179 both established a Statewide Tolling Enterprise within the Department of Transportation that will be established as a state agency (not a component unit). The legislation authorized the State Highway Commission to transfer funds to the enterprise for start-up costs. The enterprise is required to repay the State Highway Fund the amounts transferred plus interest at a rate set by the State Highway Commission. The enterprise is authorized to issue debt and collect tolls on new highways. It is prohibited from establishing tolls on existing state highways.

The Legislature made several changes in the governing structure of Colorado's higher education. It passed legislation that established a Board of Trustees for Fort Lewis College. Fort Lewis College was previously governed by the State Board of Agriculture, which is now known as the Board of Governors of the Colorado State University System. The Board of Governors of the Colorado State University System is also responsible for the Colorado State University - Pueblo that was formerly known as the University of Southern Colorado. The Trustees of the State Colleges in Colorado previously governed Metropolitan State College; it is now governed by an independent Board of Trustees for Metropolitan State College of Denver. In general, these changes were made to move governance of rural and regional institutions of higher education closer to the institutions.

Rising health care costs affect the state both through its contribution to employee health care plans and through its match of Medicaid funds. The state increased its contribution to employees' health care funds for the first time since 1994. A transfer from the Group Benefits Plan, a Pension and Employee Benefits Trust Fund, to the General Fund funded a portion of the increased contribution. Legislation also changed several of the laws governing reimbursement of managed care organizations under the Colorado Medical Assistance Act.

BUDGETARY AND OTHER CONTROL SYSTEMS

The annual budget of the state for ongoing programs, except for federal and custodial funds, is enacted by the General Assembly. New programs are funded for the first time in the enabling legislation and continued through the Long Appropriations Act in future periods. For the most part, appropriations lapse at the end of the fiscal year unless extenuating circumstances prompt the State Controller to approve an appropriation rollforward. Capital construction appropriations are normally effective for three years.

The state records the budget in its accounting system along with federal awards and custodial funds of the various departments. Revenues and expenses/expenditures are accounted for on the basis used for the fund in which the budget is recorded except for certain budgetary basis exceptions (See Note 8-B). Encumbrances are also recorded and result in a reduction of the budgeted spending authority. Encumbrances represent the estimated amount of expenditures that will be incurred when outstanding purchase orders, contracts, or other commitments are fulfilled. Encumbrances in the General Fund are not reported as a reservation of fund balance unless the related appropriations are approved for rollforward to the subsequent fiscal year. Fund balance is reserved for encumbrances that represent legal or contractual obligations in the Capital Projects Fund and the Department of Transportation's portion of the Highway Users Tax Fund.

In developing the state's accounting system, consideration has been given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition. Those controls also assure the reliability of financial records for preparing financial statements and maintaining the accountability for assets.

The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from that control. The evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within this framework. We believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

RISK MANAGEMENT

The state self-insures its agencies, officials, and employees against the risk of loss related to general liability, motor vehicle liability, and workers' compensation. Property claims are not self-insured, as the state has purchased insurance. The state uses the General Fund to account for the risk management function including operations and all current claims or judgments. (See Note 6-G page 71, Note 22 on page 90, Note 26 on page 96). Actuarially determined and other long-term risk management claims are reported only on the government-wide *Statement of Net Assets.* Medical claims for officials and employees are managed through the Group Benefits Plan Fund, a Pension and Employee Benefits Trust Fund. The Regents of the University of Colorado are self-insured for workers' compensation, auto, general, and property liability.

CASH MANAGEMENT

Statutes permit the State Treasurer to invest cash that is not immediately needed to pay obligations of the state. These investments may consist of obligations of the United States, commercial paper of prime quality, repurchase agreements, bank acceptance agreements, and other investment instruments. The State Treasurer also invests funds of the Colorado Water Resources and Power Development Authority, a component unit, and the Great Outdoors Colorado Trust Fund, a related party. Both are accounted for in the treasurer's agency funds. At June 30, 2002, the State Treasurer held the following investments at fair value:

Investment Type	Amount in Millions
U.S. Government Securities	$ 1,586.9
Corporate Bonds	1,096.9
Asset Backed Securities	525.0
Mortgages	705.6
Mutual Funds	278.1
Total	$ 4,192.5

Included above is $1,100.4 million belonging to the Colorado Compensation Insurance Authority, a related party that the State Treasurer maintains in an individual Investment Trust Fund. The financial statements of that fund are included in this report.

INDEPENDENT AUDIT

The State Auditor performs an audit of the Basic Financial Statements. The opinion of the auditor is on page 16 of this report. Besides auditing the statewide financial statements, the auditor will from time to time audit the financial statements and operations of various departments and institutions within state government.

In 1996, the United States Congress amended the Single Audit Act of 1984. The amended act clarifies the state's and the auditor's responsibility for ensuring that federal moneys are used and accounted for properly. Under the requirements of this act, transactions of major federal programs are tested. The state prepares a

Schedule of Expenditures of Federal Awards for inclusion in the State Auditor's Statewide Single Audit Report. The State Auditor issues reports on the schedule, the financial statements, internal controls, and compliance with the requirements of federal assistance programs.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Colorado for its comprehensive annual financial report for the fiscal year ended June 30, 2001. This was the fifth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS

In conclusion, I thank my staff and the staffs of all the state departments and institutions whose time and dedication have made this report possible. I reaffirm our commitment to maintain the highest standards of accountability in financial reporting.

Sincerely,

Arthur L. Barnhart
State Controller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Colorado

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2001

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

President

Executive Director

PRINCIPAL ORGANIZATIONS AND KEY OFFICIALS